

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 95-0524 ITC
Indiana Corporation Income Tax
For The Tax Periods: 1988 through 1991

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ISSUES

I. **Indiana Gross Income Tax**: Interstate Wholesale Sales

Authority: IC 6-2.1-2-2; 45 IAC 1-1-49

Taxpayer protests the inclusion of certain wholesale sales receipts included in gross income.

II. **Indiana Adjusted Gross Income Tax**: Net Expense Addback

Authority: IC 6-3-2-1(b); IC 6-3-1-3.5(b); 45 IAC 3.1-1-62; Department of Revenue v. Endress and Hauser, Inc., 404 N.E.2d 1173 (1980); IRC Section 63

Taxpayer protests the Department's addback of net expenses in calculating adjusted gross income.

III. **Indiana Gross Income Tax**: Sale of Stock

Authority: IC 6-2.1-2-2; 45 IAC 1.1-6-2; 45 IAC 1.1-1-3; SFN Shareholders Grantor Trust v. Indiana Department of State Revenue, 603 N.E.2d 194 (1992)

Taxpayer protests the Department's inclusion of a stock sale in gross income.

IV. **Indiana Adjusted Gross Income Tax**: Michigan Single Business Tax

Authority: IC 6-3-2-1(b); IC 6-3-1-3.5(b); Trinova Corp. v. Dept. of Treasury, 498 U.S. 358 (1991); First Chicago NBD Corp. v. Department of State Revenue, 708 N.E.2d 631 (Ind.Tax, Mar 31, 1999)

Taxpayer protests the Department's addback of taxpayer's payment of Michigan Single Business Tax.

V. **Indiana Adjusted Gross Income Tax**: Subpart F Income

Authority: IC 6-3-2-12; IRC Section 951

Taxpayer protests the Department's failure to exclude foreign source dividends in arriving at adjusted gross income.

VI. **Indiana Adjusted Gross Income Tax**: Net Operating Loss Carryforwards

Authority: IC 6-3-4-14; IRC Section 1562; Treas. Reg. Section 1.1502

Taxpayer protests the Department's disallowance of net operating loss carryforwards in arriving at adjusted gross income.

STATEMENT OF FACTS

Taxpayer and affiliates filed a consolidated Indiana return. Additional facts will be provided when necessary.

I. **Indiana Gross Income Tax**: Interstate Wholesale Sales

DISCUSSION

Affiliate taxpayer is an out-of state corporation. Affiliate taxpayer is not a resident or domiciliary of Indiana. In Indiana, an income tax, known as the gross income tax, is imposed upon the receipt of:

- (1) the entire taxable gross income of a taxpayer who is a resident or domiciliary of Indiana; and
- (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana.

IC 6-2.1-2-2. Audit included interstate wholesale sales receipts in taxpayer's gross income. Audit included these receipts based on activities performed by two of taxpayer's employees. Taxpayer refers to a Letter of Findings issued in 1980 to support its position that these wholesale sales should not be included in its gross income. This ruling remained valid until December 31, 1995, when Tax Policy Directive #9 was issued. Therefore, the Department finds that for the tax years at issue, the wholesale sales receipts at issue should not be included in gross income.

FINDING

Taxpayer's protest is sustained.

II. Indiana Adjusted Gross Income Tax: Net Expense Addback**DISCUSSION**

Indiana adjusted gross income tax is imposed upon adjusted gross income of a corporation that is derived from Indiana sources. IC 6-3-2-1(b). Indiana adjusted gross income is the same as “taxable income” (as defined by Section 63 of the Internal Revenue Code) and adjusted according to IC 6-3-1-3.5(b). To arrive at taxpayer’s adjusted gross income, the Department added back to taxpayer’s IRC Section 63 taxable income an amount deemed “net expense addback”. This audit calculation was justified by 45 IAC 3.1-1-62 that allows special calculations, in “limited and unusual circumstances,” to be made when “standard apportionment provisions produce incongruous results.”

Taxpayer contends that the “net expense addback” is essentially a disallowance of expenses allowed by the Internal Revenue Code in arriving at IRC Section 63 taxable income. Pursuant to IC 6-3-1-3.5(b), there are specific “addbacks” authorized under the Internal Revenue Code. Taxpayer argues that the “net expense addback” is not authorized by statute. Taxpayer argues that 45 IAC 3.1-1-62 only applies to apportionment and allocation once taxable income has been determined. Citing Department of Revenue v. Endress and Hauser, Inc., 404 N.E.2d. 1173 (1980), taxpayer argues that audit has no basis for departing from IRC Section 63 taxable income as the starting point, or disallowing expenses properly allowable in arriving at IRC Section 63 taxable income. The file does not contain evidence sufficient to support the adjustment pursuant to the applicable statute.

FINDING

Taxpayer’s protest is sustained.

III. Indiana Gross Income Tax: Sale of Stock**DISCUSSION**

Affiliate taxpayer sold all of its stock in a subsidiary, also an affiliate taxpayer. The sale was made to a third party. The parties elected under IRC Section 338(h)(10) to have a sale of stock “deemed to be” as a sale of assets by taxpayer for federal income tax purposes. In audit, these receipts were included in taxpayer’s gross income. Taxpayer argues that because the Indiana gross income tax does not incorporate by reference the Internal Revenue Code, an IRC Section 338(h)(10) election is not recognized for gross income tax purposes.

Taxpayer contends that the stock sale remains a sale of stock by a nonresident corporation, commercially domiciled outside Indiana. Thus, the sale is not subject to Indiana gross income tax. Since the affiliate taxpayer making the sale did not have business situs within Indiana, the receipts cannot be included in taxable gross income.

Indiana imposes a gross income tax, known as the gross income tax, upon the receipt of “the taxable gross income derived from activities or businesses or any other sources within Indiana by

a taxpayer who is not a resident or a domiciliary of Indiana.” IC 6-2.1-2-2. In general, receipts derived from an intangible are included in gross income. 45 IAC 1.1-6-2. Intangible means a personal property right, which exists only in connection to something else. 45 IAC 1.1-6-2. Stocks are considered intangibles for gross income tax purposes. 45 IAC 1.1-6-2. Thus, the sale of stock should be included in gross income unless “the intangible does not form an *integral* part of a trade or business situated and regularly carried on at a *business situs* in Indiana, *and* the taxpayer’s commercial domicile is located outside Indiana.” 45 IAC 1.1-6-2(c)(2). To determine whether affiliate taxpayer’s sale of stock is subject to Indiana gross income the following issues must be resolved:

- (1) Affiliate taxpayer must have “business situs” in Indiana
- (2) The stock must form an “integral” part of business carried on at taxpayer’s business situs in Indiana

“Business situs” arises where possession and control of a property right have been localized in some business activity away from the owner’s domicile. 45 IAC 1.1-1-3. Affiliate taxpayer, that made the sale of its subsidiary’s stock, is commercially domiciled outside Indiana. Affiliate taxpayer that sold stock did not have business situs in Indiana. The subsidiary had Indiana assets and property in Indiana sufficient to constitute business situs. However, the affiliate taxpayer that made the sale of stock is not liable for Indiana gross income tax on proceeds from the sale of all of a subsidiary’s stock, even when the subsidiary has property and assets in Indiana, because such income is not derived from Indiana sources. SFN Shareholders Grantor Trust v. Indiana Department of State Revenue, 603 N.E.2d 194 (1992). Thus, the second prong of the test stated above need not be discussed. The affiliate taxpayer did not have business situs in Indiana and therefore the sale of stock is not subject to Indiana gross income tax.

FINDING

Taxpayer’s protest is sustained.

IV. Indiana Adjusted Gross Income Tax: Michigan Single Business Tax

DISCUSSION

Indiana adjusted gross income tax is imposed upon adjusted gross income of a corporation that is derived from Indiana sources. IC 6-3-2-1(b). Indiana adjusted gross income is the same as “taxable income” (as defined by Section 63 of the Internal Revenue Code) and adjusted according to IC 6-3-1-3.5(b). One of the adjustments requires the taxpayer to add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 63 of the Internal Revenue Code for taxes *based on or measured by income* and levied at the state level by any state of the United States. (Emphasis added) IC 6-3-1-3.5(b)(3).

Taxpayers pay Michigan Single Business Tax (“MSBT”). They deduct MSBT in arriving at Section 63 taxable income for federal income tax purposes. The Department added back MSBT to arrive at taxpayers’ Indiana adjusted gross income. However, in Trinova Corp. v. Dept. of Treasury, 498 U.S. 358 (1991), the Supreme Court held that the MSBT is a value-added tax and

not a tax on income. Accordingly, in First Chicago NBD Corp. v. Department of State Revenue, 708 N.E.2d 631 (Ind.Tax, Mar 31, 1999), the Indiana Tax Court held that MSBT was not a tax based on or measured by income. Thus, the MSBT should not be added back to arrive at taxpayers' Indiana adjusted gross income.

FINDING

Taxpayer's protest is sustained.

V. Indiana Adjusted Gross Income Tax: Subpart F Income

DISCUSSION

To arrive at adjusted gross income, IC 6-3-2-12 allows a "foreign source dividend" deduction. "Foreign source dividend" includes "any amount that a taxpayer is required to include in its gross income for a taxable year under Section 951 of the Internal Revenue Code." IC 6-3-2-12(a). Taxpayer contends that audit failed to exclude IRC Section 951, "Subpart F income," in arriving at taxpayer's adjusted gross income.

To the extent that taxpayer received foreign source dividends that should have been excluded from adjusted gross income, the Department should have deducted foreign source dividends in arriving at adjusted gross income.

FINDING

Taxpayer's protest is sustained to the extent that any Subpart F income received by taxpayer was included in arriving at the taxpayer's adjusted gross income.

VI. Indiana Adjusted Gross Income Tax: Net Operating Loss Carryforwards

DISCUSSION

The Department disallowed net operating loss carryforwards (NOLs) incurred by taxpayer affiliate during the above years. The auditor applied separate return limitation year (SRLY) rules to limit the amount of taxpayer's NOLs. Taxpayer argues that there is an exception within the SRLY rules that should allow taxpayer to carry forward the amounts disallowed by audit.

Taxpayer argues that a SRLY does not include a separate return year of a corporation that was a member of the affiliated group for each day of the loss year, provided that an election under IRC Section 1562(a) concerning multiple surtax exemptions was not in effect for such year. Treas. Reg. Section 1.1502(f)(2)(ii)(iii). Taxpayer contends that taxpayer affiliate was a member of the taxpayer's affiliated group for each day of the years for which the loss was disallowed. Taxpayer states that since IRC Section 1562 elections have been unavailable since 1974 there would have been no election made under that section for this affiliated group for any of those loss years. Taxpayer submitted documentation to support its contention. The Department finds

that affiliate taxpayer falls under the exception provided in the SRLY rules. Therefore, the NOLs should have been allowed in arriving at adjusted gross income tax.

FINDING

Taxpayer's protest is sustained.